Collections in Foreign Trade

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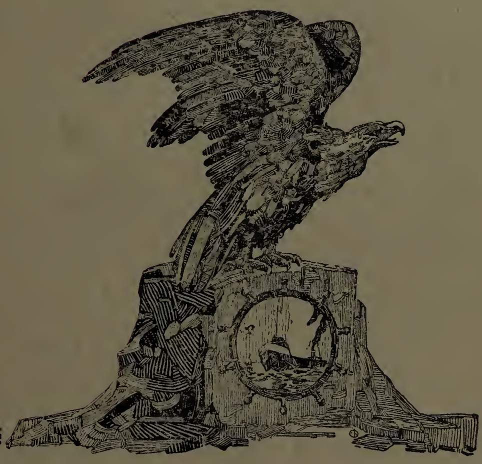

Central
National Bank
Savings & Trust Co.
of Cleveland

Collections in Foreign Trade

CABLE ADDRESS "CENTRAL"

COLLECTIONS IN FOREIGN TRADE

FOREWORD

THIS booklet is the last of a series of four, covering every phase of Foreign Trade, as follows:

1. Laying the Foundation.
2. Pricing Goods for Export.
3. Filling the Export Order.
4. Collections in Foreign Trade.

No effort has been spared to make these booklets thoroughly practical and devoid of generalities. The subject matter is the outcome of actual experience, the aim being to combine brevity with the maximum of helpful information.

The other units to complete this series of booklets will be furnished by our Foreign Department on request as issued. This institution offers its services to those interested in developing their export business and will be pleased to supplement the information given in these booklets.

**Central National Bank
Savings & Trust Co**

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IN the preceding unit the question of paramount importance to the buyer was discussed, namely, delivery of the merchandise at destination in perfect condition, at minimum cost to the customer. In this booklet will be considered that phase of the transaction of utmost interest to the seller—Collections on Export Sales.

A collection record practically free from losses on the year's foreign sales is very largely a matter of exercising the same caution and good judgment in extending credit as is customary in domestic business. Added to this, however, is the necessity of a clean-cut understanding of the various methods of financing and collections in international usage, the exact significance of the different terms under discussion in an interchange of correspondence, and what terms your foreign competitor will probably offer in a given market.

Recent Credit Data Important

First, learn all you possibly can about the credit risk involved; a firm entitled to the highest credit rating before the war, or in fact only six months ago, may be in a far different financial condition today. Accordingly new credit reports are necessary and

these should be secured from several different sources. The usual credit information agencies of this country will secure foreign reports for a moderate fee, and this Bank can extend valuable assistance to its clients in making such investigations.

It should be especially noted whether the purchaser is a limited company or an individual; the degree of prosperity during and since the war, general reputation for promptness in payment, and whether inclined to take advantage of technicalities.

After collecting all available financial data, the proper sales conditions may be determined. Aside from the credit strength of the buyer, the terms of sale will be influenced in a measure by the nature of the commodity; whether it can be readily disposed of at destination in case of failure of buyer to protect payments, whether it is of a seasonal character, etc.. From the above it will be noted that no rigid rule can be formulated embodying the terms of sale applicable to all lines of trade.

In every case, the sales terms should be fully agreed upon making certain that all of the conditions are clearly understood by the buyer. The various terms may be as follows:

(1) Cash with order.

(2) Cash in New York by bank credit opened in favor of Seller, payment to be released upon delivery of complete set of documents.

Collection in Foreign Trade

(3) A sight draft at destination.

(4) A time draft at destination, for 30, 60 or 90 days, and even in some cases 120 days sight.

(5) Long time credits with interest.

(6) Open account.

Cash with Order

Discussing the first possibility, *Cash with order*, this is customary only where highly specialized or made to order articles are concerned and even in that event, it is not unusual to have only 25 or 50 per cent with order, the balance to be taken care of on a more liberal basis. The other type of sales in which cash with order is frequent is in the case of introductory offers covering sample shipments, or with that class of business transacted by the large retail mail order houses direct with consumers throughout the world. While referring to sample shipments, the facilities offered by the Parcel Post should not be overlooked. Packages weighing a maximum of 22 pounds may be mailed to many countries, while to others the limit of weight is 11 pounds. Such packages must not be

sealed, neither can they be insured or forwarded C. O. D. The possibilities of utilizing the parcel post service are valuable in many lines and are entitled to careful study by the export department. Aside from the case of highly specialized articles and small mail shipments, however, the request for cash with order has little or no place in foreign trade.

Cash Against Documents in New York

In the case of *Cash in New York by bank credit*, payable upon delivery of complete set of documents, such a credit may either be revocable or irrevocable. In the first instance, although a date of expiration is usually specified, such a credit is nevertheless subject to cancellation at any time, upon instruction to the bank from the foreign buyer. In the case of the irrevocable credit, no cancellation is possible prior to the date specified upon the credit, without the consent of the party in whose favor it is drawn. It will be understood, therefore, that this constitutes a much stronger protection to the Seller than the revocable credit and upon receiving the bank notification that credit has been opened, this point should be especially noted. If no form is specified the probability is that the credit is revocable and this fact should be definitely ascertained before accepting the order. In every case, the conditions

stipulated in the credit notification must be adhered to strictly by the shipper, as failure to fully conform to any point may cause withholding of funds by the bank.

For instance, the writer recalls a shipment to Volo, Greece, which it was necessary to transship at Piraeus, and which the buyer instructed should be so transshipped. In opening the credit, however, he neglected to instruct the bank to accept bill of lading to Piraeus, with transshipment to Volo, and funds could only be released by the bank after receipt of a cable direct from the Buyer that this mode of shipment was acceptable to him.

Disposition of Documents

Note that this method of payment requires delivery of a complete set of documents to the bank. In the booklet "Filling the Export Order," we discussed the documents which are prepared at the factory and forwarded to the freight forwarding agency, with which to clear the shipment at the port. On another page is explained the mode of issuing the ocean bill of lading, insurance certificates, and the consular requirements, if any. The next step in connection with the documents is their use in securing payment under certain terms of sale, and in all cases, placing them in

possession of the party who will take delivery abroad.

The total number of copies of steamship bills of lading required varies with different steamship companies who retain from two to four copies, seven copies being usually issued. The first three of these constitute the negotiable copies and are so stamped, the remainder being for the convenience of the shipper and consignee. Possession of any one of the negotiable copies gives the holder title to the merchandise hence in honoring draft with documents attached, the bank insists upon receiving all three of these Bs/L, made out "To Order" and endorsed in blank, or to the order of the bank. To these bills of lading are attached the original and duplicate insurance policies, drawn in similar manner, the required number of consular or commercial invoices and certificates of origin depending upon the country of destination, and one or more copies of the packing list as a matter of convenience.

The utmost care must be exercised by the bank to have the above documents mailed to its correspondent bank or to consignee on the vessel carrying the merchandise, to prevent serious inconvenience and frequently heavy expense at destination. Generally consignee must produce documents within 48 hours after arrival of the vessel; otherwise he is assessed for storage and fines.

In forwarding the negotiable documents, the bank separates them into two sets, the duplicate documents following the original upon the next steamer. This, of course is a precaution against loss or accident to the papers, and one set having accomplished its purpose, the other is void.

It is always advisable to send non-negotiable or record copies of all documents direct to the buyer at the earliest moment possible. This allows additional time before receiving those which pass through the bank, in which to make his arrangements for delivery of this goods.

Sight Draft at Destination

In regard to *Sight Draft at Destination*, this procedure offers certain conveniences to the buyer not found in the preceding method and is much more popular with the customer. His funds are not tied up for any length of time as is the case when payment is made against surrender of documents in New York, while the Seller is compelled to await the proceeds of the sale for the period required for the draft to reach destination and proceeds to be returned. While interest to cover this period, as well as collection and exchange costs, may be stipulated at the expense of the buyer, nevertheless some manufacturers prefer to make

the selling price sufficiently liberal to cover these charges.

Drafts are drawn in dollars, sterling, or occasionally in other currency, depending upon the conditions of payment agreed upon, this being an item of considerable importance, due to fluctuations in the rates of exchange. Where Dollar drafts are used, they should bear the clause, "Payable at the holding Bank's selling rate for sight drafts upon New York." Bills of exchange drawn in dollars against Australia or South Africa bear a slightly different clause; namely: "To be converted into sterling at the Bank (Name of holding bank) rate on due date, and payable at the current rate of exchange for purchasing demand drafts on London." If such draft is drawn in pounds, however, the Colonial Clause then stamped upon it is "Payable with exchange, English and colonial stamps added, at the current rate in London for negotiation of bills on the colonies."

Your banker, will of course watch for the occasions when the above clauses are required and rectify any omission on the part of the drawer of such drafts.

Clear Instructions to Bank Needed

If interest and collection fee are to be added to the face of bill for payment by drawee, this fact

should be included in the clauses just cited. The bank must always receive clear instructions concerning the details of collection, whether drafts are to be protested in case of non-payment, whether Seller wishes cabled notification in event of any difficulty arising, etc.

Whether draft is for payment or for acceptance at sight, instruct the bank clearly whether the instrument is to be held for presentation pending arrival of the shipment, which it covers.

When drawing at sight at destination, it is customary to make this a "documentary draft," that is, one to which all negotiable documents are attached as explained under the preceding method. However, in connection with any of the terms here explained, if the Seller has implicit confidence in the Buyer he may send him the documents direct and forward the draft through the bank as a "clean draft" (without documents) or with merely record copies of documents as a matter of reference. This, of course, is advisable or is practised only between concerns who have had dealings covering a period of time and where the Buyer's credit is gilt-edged.

Instead of drawing against the Buyer, the manufacturer may insist that a bank credit be opened by the purchaser's local bank, against which drafts are drawn and such credit may be either

confirmed or unconfirmed; that is, irrevocable or revocable.

The bank will charge a moderate fee for extending this credit to the buyer. This fee varies in different countries. Bills against such a credit must be drawn in exact accordance with instructions from the bank, for payment under the credit specified.

Time Draft at Destination

The next term is *A Time Draft at Destination* for the tenor agreed upon such as 30, 60, or 90 days from sight. In this instance, just as in the preceding case, the drawee may be the buyer of the goods or a bank, the new element being that it may be a D/P or D/A draft ("documents against payment" or "documents against acceptance"). Such a time draft may be drawn against buyer with documents attached for surrencder upon payment at 30 days or 60 days, according to the time agreed upon, the purpose being to give him an opportunity to make certain the goods have arrived before he is called upon to honor the draft. When documents are mailed by a fast vessel and the shipment goes forward upon a slow freight steamer, this clause is a protection, especially since the drawee can take up the draft and secure the documents prior to maturity of the paper, should he so prefer.

If the buyer's credit is sufficiently strong, the

Seller may not insist upon the bank retaining the documents pending actual payment of the draft, but stipulates instead that they be surrendered against acceptance on the part of the buyer. In that case, the customer endorses his acceptance, usually across the face of the document, and the maturity of the draft is calculated from the date of this acceptance. This would be an ordinary commercial acceptance, and would either be held by the bank at destination for collection at maturity or returned to the Seller, who might wish to discount the paper, which would be with recourse to himself.

Surrender of documents against Customer's acceptance offers somewhat scant protection to the Seller, it being in the hands of the Buyer to honor draft which he has accepted upon its maturity. Should exchange be unfavorable at time of maturity, buyer will occasionally request an extension, for that reason. This method of payment is of course better than open account in reducing the maturity date to an exact matter of record, especially in view of the laws prevailing in certain countries which make failure to honor such a draft a more serious matter than in the United States.

The Bank Acceptance

If, however, this time draft were drawn against

a bank instead of against the buyer, it would now bear the bank's endorsement, or become a banker's acceptance. The procedure frequently followed is for the credit established through the foreign bank to be confirmed by its American correspondent bank, which then accepts the bill at New York. It should be borne in mind, however, that such an acceptance is a very different negotiable document from that described in the preceding paragraph. The use of the bank acceptance is somewhat new in America, although it is an old established practise in some countries. It involves the use of the bank's credit, just as explained when drawing against a letter of credit established through the bank. In the case of the acceptance, however, instead of paying the sum at once, the bank will accept the draft with all negotiable documents and assume title and ownership to the shipment. These documents it will in turn deliver to the consignee usually against a "Trust receipt." This is an agreement, signed by the Purchaser, acknowledging receipt of the goods and agreeing to sell and apply the proceeds to paying the draft. Whether or not the goods are sold, the consignee is obligated to turn over to the bank the necessary funds in time to permit the bank to make payment of the draft upon maturity. Such an acceptance of an American Bank is prime negotiable paper (and eligible for rediscount with

a Federal Reserve Bank, readily discountable of course in any commercial bank), the accepting bank making itself responsible for the payment.

An Ideal Method of Financing

Occasionally where a time draft is drawn for the value of the goods, a sight draft is agreed upon to cover the transportation and insurance, consular fees, etc., all of which are a cash outlay on the part of the exporter, as all ocean shipments are prepaid.

A bank acceptance, as above explained, is subject to terms as agreed upon between the bank and its client who may be called upon to furnish collateral or otherwise fully protect the bank, these conditions being specified in an acceptance agreement entered into between the bank and the foreign buyer. Not only does the practice vary, depending upon the firm seeking the accomodation, but the details differ in various countries.

The use of the bank acceptance, confirmed by the American correspondent bank of the institution in the foreign country, offers to the newcomer in export trade the ideal method of financing. The expense is slight and the safety is measured only by the strength of the banks which are the acceptors. Under these terms, the American bank is obliged carefully to scrutinize the documents; they must be in exact accord with the

instructions held by the bank which, it must be understood, is acting as an agent of the foreign bank and is without authority to permit the slightest deviation from the conditions set forth in the letter of credit. This would cover date of shipment, quantity of merchandise, and similar salient features, and these being complied with, it becomes obligatory upon the bank to make payment. Since the recent downward trend in prices, a certain amount of litigation has arisen through efforts to stop banks from making payments under acceptance of letters of credit. Technical objections to the merchandise and similar claims were advanced but it has been held by the court that two distinct contracts exist, that with the bank being separate from the commercial agreement between buyer and seller, and redress, therefore, must be secured by claim against the buyer and not through enjoinder to prevent payment of bank acceptance.

Granting Long Time Credits

Now we come to the *Long Time Credit with interest*. This is the method of financing practised especially before the war by certain European manufacutrers in their sales to some of the less developed or agricultural countries in connection with such articles as farming machinery, or other staple products. The American manufacturer has

never taken kindly to this practice, and in fact, since the war there is some disposition on the part of the European exporter to shorten the period. In countries where long terms are customary, one reason is the high banking rate of interest charged, which may be from 8 to 12 per cent. Naturally, therefore, if the Seller will carry the account for six months at from 6 to 8 per cent, this is much more attractive to the buyer than to borrow locally to liquidate a short time draft. It must be understood, therefore, that the request for long terms does not necessarily mean a lower credit standing.

In agricultural countries, for instance, where there is one principal crop such as sugar, cotton, or coffee, the local dealer is usually extending credit to the bulk of his trade until the harvesting season and he endeavors to have his own obligations mature in such a manner that he can meet them when his customers make their annual or semi-annual settlements with him. It must be remembered that the European manufacturer who was accustomed, before the war, to granting such terms was usually able to do so discriminatingly and therefore more safely than the American manufacturer and particularly the American manufacturer not thoroughly experienced in foreign trade.

Likewise trade conditions were then far different

from today. Probably the European Seller had been dealing with his foreign customer for years or even for several generations; his salesmen were trained to gather invaluable detailed credit information on each trip. This entered into such details as the various customers of the buyer and their standing; probable profits from sales to the various houses; investments such as they could learn of; local bank balances; domestic relations such as the financial interests of wife; or in fact any circumstances which might affect the granting of credit to the firm in question. Only when the American manufacturer subjects his credit risks in other countries to the same continuous, detailed scrutiny will he have the same degree of justification and safety in granting the sales terms here enumerated. In this connection it might be mentioned that such terms are sometime dated from time of shipment instead of from acceptance of draft. Any credit extension so calculated, of course, throws upon the buyer the burden of time in transit for the shipment. In shipping to the East Coast of South America and to various European Countries the European manufacturer can usually effect quicker delivery than the American. This is due both to distance and frequency of sailings and is a point which the shrewd international buyer of long experience does not overlook.

Selling on Open Account

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Selling on Open Account is a financial "No Man's Land" for the firm just beginning or possessing only limited experience in foreign trade and should accordingly be approached with due caution. Do not leave it entirely out of your reckoning but be fully cognizant of the risks attendant upon this method of sale. Undoubtedly there are fine, high principled commercial houses among the people of every nation whose financial strength is unsurpassed, and whose "word is their bond," but the crux of the question is to *know* absolutely that it *is* to such a house that you are selling in this free and easy manner. After years of dealings with a concern, assuredly this method of sale becomes entirely legitimate and will go far to strengthen the bonds of good-will, but it is with these years of intercourse with which comes the experience not possessed by the firm just beginning its foreign trade career. The prominent American export commission houses transact a large volume of business annually on open account, but these firms are thoroughly experienced in the peculiarities of each country, the amount of business handled is sufficiently large to be very remunerative and they very frequently have their own branches in the country of the buyer which can protect their interests in case of need.

The above paragraphs cover the various methods

of financing in general practice in a very brief manner, although there are numerous variations and combinations which arise in daily export transactions. This fact is due to the customary trade practice of different countries or regions of the world, as a method in common usage in one locality is totally unknown in another. However, this bank places itself at your service in assisting you in every phase of foreign financing and will consider it a privilege to co-operate with you to the fullest extent. In fact, to meet the demand existing, we have recently arranged to discount or buy bills covering foreign shipments, against delivery of domestic bills of lading, instead of ocean bills, as is customary. In providing such accomodations, our client has the domestic bill of lading issued "to order" and surrenders to us this B/L duly endorsed, together with all other documents required in the transaction. This may save weeks, or even in some cases a month or so, to the manufacturer, in securing the use of the funds involved. We shall be glad to discuss this with you if you are interested.

A Foreign Trade Innovation

Discounting against the domestic bill of lading is an innovation in foreign trade, the usual practice being to discount the draft with all documents attached. The bank which purchases the bill immediately forwards it with documents for accep-

tance or payment, according to the terms of sale. Under this arrangement the loan of funds is based primarily upon the credit strength of the Seller, although possession of the documents which convey title to the goods in as additional safeguard to the bank making the advance.

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Note that all of the bills described above are "To order" of the shipper; bear in mind, however, that this method of shipping is not permissible to Panama, Venezuela, Colombia, Santa Domingo and Guatemala, where the customs laws prevent this method either by prohibiting it or by failing to require presentation of the bill of lading for clearance purposes. The alternative is to make previous arrangements to consign direct to a bank or import agent; in such event care must be exercised that the name of the ultimate buyer does not appear on the shipment or in any of the documents.

Dollar Credits

The Federal Reserve Act, which gave our American banks the right to accept bills drawn upon them backed by import and export of commodities, has made possible Dollar exchange instead of limiting our international trade largely to Sterling. Doubtless Sterling will retain its pre-eminence, London being the money market of the world, although Dollar credits offer a convenience and economy to the American manufacturer which he

should fully comprehend. Primarily, the Dollar credit is more economical as the commission for issuance is less; the basis of issue is a definite known factor which eliminates the exchange risk. The rate of discount on prime bank acceptances in dollars is apt to be lower than for Sterling or Continental exchange. It should further be a matter of pride to the American exporter or importer to extend the use of the Dollar Credit wherever possible.

While not actually a matter of financing the shipment, the question of "Drawback" may have quite a bearing upon your profits. During the year 1914, nearly $5,000,000 was refunded to American manufacturers under this provision of the Government. If you export a commodity in the manufacture of which there enters the use of imported material on which import duty has been paid, 99 per cent of the amount so paid is refunded, upon going through the proper formalities, which are usually entrusted to special brokers. To secure the benefit of drawback the manufacturer must keep an accurate record of the quantity of imported materials used in his own production, by whom imported and when, also rate of duty paid.

Insurance is another matter closely associated with the financial side of international trading. Marine insurance has no resemblance to fire in-

surance, and is extremely technical and intricate. If the shipment is forwarded through a freight forwarding broker, he will cover it with insurance under your instructions. It should be clearly stated whether this should cover from dock to dock or from warehouse to warehouse, whether or not pilferage should be insured against, and similar questions. It is customary to protect the shipment for 10 per cent above the c. i. f. value. Usually goods are insured free of particular average, in which event partial loss is not paid for.

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The subjects covered very briefly in this booklet are of the utmost importance to the manufacturer in intelligently advancing his interests and securing his share of international trade. As previously stated it is not the purpose to treat exhaustively the subject here, but rather to give the manufacturer an idea of the possibilities and a caution against the pitfalls to be encountered, bearing in mind our desire to elaborate upon any question or lend any assistance which lies within our power.